NO. 83-1354

IN THE SUPREME COURT OF THE UNITED STATES

JANUARY TERM, 1984

MORRIS SANKARY, WANDA SANKARY, Petitioners

v.

COMMISSIONER OF THE INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

(1) Were the advances and guarantees made by the taxpayer to and on behalf of Continental Components Corporation loans or contributions to capital as contended by the Commissioner?

(2) Do Petitioners' losses from the loans and from the guaranties made on behalf of the corporation qualify as business losses within the meaning of Section 166(a) of the Internal Revenue Code?

(3) Were the losses from the stock acquisition loans and guaranties deductible in any event as business losses?

NO._____

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is unreported.

The judgment of the United States Court of Appeals is attached in Appendix "A" hereto, infra, pages 27-59. The Journal Entry of Judgment of the Tax Court of the United States is attached in Appendix "A" hereto, infra, page 59.

JURISDICTION

The judgment of the United States Court of Appeals (attached in Appendix "A", infra, pages 27-59), was entered on October 24, 1983. A timely petition for rehearing was denied on November 18, 1983. (Attached in Appendix "B" hereto, infra, pages 60-61). The jurisdiction of the Supreme Court is invoked under 28 USCS §1254(1).

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code Section 166(a)(1)

Internal Revenue Code Section 166(d)(1)

Treasury Regulations Section 1.166-1(c)

The pertinent text of the above-listed statutes and regulation is set forth in Appendix "C" hereto, infra, pages 62- 63.

STATEMENT OF THE CASE

Petitioners, MORRIS SANKARY and WANDA SANKARY, during the tax years in question, were husband and wife and filed joint tax returns. Petitioners have been divorced since 1977.

Both Petitioners were admitted to the practice of law in the State of California in 1950.

Petitioner, MORRIS SANKARY, clerked for the Honorable Judge James M. Carter in the United States District Court in Los Angeles, California. He thereafter, in 1952, went to work in the United States Attorney's Office in Los Angeles, California, as an Assistant United States Attorney, and was transferred to the San Diego Office in that year. He worked as Assistant United States Attorney from 1952 to 1954.

While in the United States Attorney's Office, Petitioner assisted in prosecuting

certain V.A. fraud cases and thus became familiar with real estate law and real estate development.

As a result of this experience, when Petitioner left the United States Attorney's Office and went into private practice in San Diego, he was retained by a Veteran's Group to represent them in claims they had against certain builders and developers. Thereafter, he began to represent certain builders and developers in their legal matters.

As his law practice developed in the area of real estate development, he, with others, purchased a lumber company, known as the Lakeside Lumber Company in 1959 and the land upon which it was situated. As a result of the ownership of this company, he came in contact with other builders and developers interested in large land developments for low cost housing, and began to represent some of them.

In addition, as his practice grew, his

clients sent him on business transactions to various parts of the world to negotiate various business deals for them, for which he would usually receive 5% or 10% of the transaction.

In 1966 or 1967 Petitioner met a Mr. Q. C. Lum, who was a large builder of low-cost housing in Hawaii. Mr. Lum had obtained a patent on a prefabricated concrete house which he wished to be marketed and asked Petitioner to represent him in finding builders and developers who might be interested in this type of low cost housing.

In 1967 Petitioner obtained an option to purchase 111 acres of land in Lakeside, California, and negotiated with one Frank Muscara, a builder-developer, to purchase the land.

In 1968 the Federal Government was interested in the development of new cities, in which there would be a planned city utilizing a total concept of low cost housing,

energy conservation, equality in racial mixes, recreational and green areas, etc. Because of the nature of his practice Petitioner became interested in these types of projects and, together with others, began working on a project of this kind in the South Bay area of San Diego County near the San Diego-Mexico International Border.

During this same period of time, 1967, Petitioner also represented Helix Land Corporation, which had large land holdings throughout San Diego County, including a parcel which ran along the Mexican Border and having about a mile-and-a-half of beach frontage extending from Imperial Beach, California, to the Mexican Border. Petitioner, in his legal practice, assisted in negotiating a deal between the Desilu Studios and Helix Land Corporation to build a Disneyland-type park on this real property.

Petitioner was involved in many other

business matters and related transactions, all of which were part of his business of practicing law.

In 1968, Petitioner was approached by a Mr. Tom Sutherland and a Mr. Ryan to represent them before the San Diego Port Authority to assist them in obtaining a permit to allow the Diner's Club International to build a floating motel and marina project in the San Diego Bay, as a test site for the development of other such projects world-wide.

In the course of discussions with Mr. Sutherland and Mr. Ryan, Petitioner was informed that both Sutherland and Ryan were employed by a company in the Orange County, California area, known as Granada Plastics, which was engaged in the manufacture of expanded polystyrene. The polystyrene would be molded into large 4X8 foot blocks and then cut into various shapes and sizes to be used for a number of purposes. The most common purpose

at the time was that these pieces would be used for packing and shipping purposes, to prevent damage to various products. In addition, the product was used for insulation, for construction projects, for flotation systems for the motel marina complex planned by Diner's Club, and in the construction of air cargo containers.

These same polystyrene blocks would also be cut into slices, 4 inches thick, 4 feet wide, and 8 feet long, and then laminated to exterior plywood and interior drywall, or various combinations of paneling, to make 4 X 8 foot wall sections, which, when used with a post beam construction design, was excellent for the low cost housing market. The system developed by Sutherland and Ryan allowed four men to erect all of the walls and roof rafters of a 1500 square foot home in one day, after the foundation was laid. The polystyrene would not only provide strength to the

building materials, but would also provide excellent insulation to meet the federal FHA requirements prescribed in the Model Cities program, as well as State requirements for low cost housing.

Mr. Sutherland and Mr. Ryan told Petitioner that the employees of Granada Plastics were given an option to purchase the company from the owner, Mr. Harold J. Kurt, but the option was expiring soon, and unless they could find someone to loan them the money they would lose their option.

Continental Components Corporation, (hereinafter referred to as "CCC"), the corporation which is involved in the tax losses claimed by Petitioners, had been formed in 1968, many months prior to Petitioner being contacted by Sutherland and Ryan, by Sutherland, Ryan and Mr. Leston, for the express purpose of purchasing the business from Mr. Kurt. At the time Petitioner was contacted to

represent Sutherland and Ryan, the corporation had engaged in no business and had issued no stock.

Sutherland and Ryan asked Petitioner to represent them in all of their business transactions, including, but not limited to, the purchase of the business from their employer (Mr. Kurt), in their dealings with builders interested in their low cost housing system, made from the expanded polystyrene, the negotiations with Diner's Club International to develop a world-wide floating motel system, negotiations with airlines for the construction of air cargo containers, negotiations with labor unions, various cities and their building departments, negotiations with F.H.A., the Bureau of Indian Affairs, and every other governmental agency having anything to do with the approval of their building system. All of these matters offered Petitioner the potential of making large sums

of money in his law practice.

During the course of these discussions, they asked Petitioner to either find someone of Petitioner's clients to loan them the money needed to purchase the business from their employer (Mr. Kurt), or for Petitioner to loan them the money himself, since the product could be used by Petitioner and his other joint venturers in the constructions of low cost housing. They agreed with Petitioner, that if Petitioner loaned the money to them, that, in addition to having Petitioner represent them and CCC in their legal affairs, that they would first repay Petitioner's loan and give him a piece of the corporate stock, in addition to his fees for his services.

They further agreed to secure the loan with all of the stock of the company until Petitioner was repaid.

At this same time, Petitioner's other clients, Mr. Lum and a Mr. Brown, were nego-

tiating for the development of a large number of low costs homes in San Diego, and upon which a commitment of $2,200,000 had been issued by Metropolitan Life Insurance Company. This project was approved by the Federal Housing Administration.

Petitioner showed the post-beam construction system developed by Sutherland and Ryan to his other clients, who expressed a real interest in using this type of housing for their development project.

Petitioner satisfied himself that the loan to Sutherland and Ryan would be reasonably secure and agreed to loan the money to them, subject to all of the conditions they had agreed to which are set forth above. Petitioner further expected that his representation of Sutherland, Ryan and CCC would lead to the development of expanding Petitioner's legal practice with other builders and developers.

Petitioner made it clear that the money which he was loaning them was strictly a loan and not an investment of capital. Sutherland and Ryan agreed that to secure Petitioner's loan with the stock of the corporation, until such time as the loan was repaid, at which time the stock would be returned to them, to be divided amongst the employees, and, with Petitioner receiving one-third of the stock in addition to his fees for legal services. Sutherland was to be President; Ryan was to be Vice-President; and Petitioner was initially to be Secretary-Treasurer of CCC.

As a result of this agreement, 1000 shares of stock of CCC were issued in Petitioner's name for the sum of $1,000.00.

In addition, Petitioner bought a piece of real property adjacent to the existing plant for the purpose of expanding the corporate facilities and leased the building and land to CCC.

Petitioner had every expectation that by meeting new developers and builders and that he would be in a position to represent some of them and thus enhance his legal practice, and Petitioner did in fact end up representing a number of these builders.

Petitioner, to make clear his intent that the transaction constituted a loan and not a capital investment in CCC, had the Corporation borrow the money from various banks. At the very inception of the project, Petitioner wrote a letter to Attorney Thomas A. Comstock, who represented Mr. Kurt, dated March 14, 1969, which set forth Petitioner's intent that the transaction was to be considered a loan and not a capital investment.

When CCC needed additional funds, CCC would borrow the money from the Bank, and the Bank required Petition to guarantee the loan. In addition, whenever additional equipment was required by the Corporation, Petitioner pur-

chased it in his own name and leased it to the Corporation.

Petitioner had every expectation that these loans and guarantees would be repaid by CCC because of the large contracts which had been executed by customers of CCC and because of the favorable response to the product from the land developers, builders, and from Government Housing authorities. Petitioner would never have guaranteed the loans unless he actually believed that the Corporation would repay these loans.

In addition, Petitioner negotiated a contract with Sears, Roebuck Company for a builder to use the panels manufactured by CCC to be used in Sear's Add-A-Room program throughout the State of California.

Mr. Sutherland, who was the principal promoter in the project, died unexpectedly in 1970, and, as a result, Petitioner was compelled to assume charge of CCC, as its Presi-

dent, to assure that the loans which he guaranteed would be repaid by CCC to the banks, and that he would not be required to pay on his personal guarantees.

At this point, Petitioner had guaranteed loans of the Corporation in the sum of approximately $325,000.00.

Petitioner then sold his interest in CCC to Otis Walton and Associates, a group of black businessmen, who were obtaining an Urban Development Loan to rebuild homes in the Watts area of Los Angeles with CCC's building system. The principal consideration in the sale was for the group to pay off the obligations to the bank so that Petitioner would be relieved from his guarantees. Petitioner turned the company over to this group, who immediately assumed control over CCC. This group defaulted in their agreement, and as a result Petitioner was required to make good on the guarantees in the amounts set forth in the

Stipulation of Facts.

It is this loss which Petitioner claims as an ordinary business loss.

On December 23, 1982, the U.S. Tax Court, T.C. Memo 1982-387, entered a Decision against Petitioner's holding that there were deficiencies in addition to the Petitioner's Federal Income Taxes as follows:

Year	Deficiency	Section 6653(a) Addition to Tax
1970	$ 421.02	---
1971	4,785.35	---
1972	43,406.00	$2,190.30
1973	31,028.00	---
1974	25,030.80	---

On January 3, 1983, Petitioners herein duly filed their Notice of Appeal to the United States Court of Appeals for the Ninth Circuit.

On October 24, 1983, the United States Court of Appeals for the Ninth Circuit affirmed the Decision of the U.S. Tax Court.

Petitioners subsequently filed a Petition for Rehearing. Said Petition was denied on November 18, 1983.

REASONS FOR GRANTING WRIT

Supreme Court Rule 17 sets forth the considerations governing review on certiorari Section 1(a) of the Rule provides that... a writ should be granted... "when a federal court of appeals has rendered a decision in conflict with the decision of another federal court of appeals on the same matter."

Petitioners contend that the decision rendered against them in the United States Court of Appeals for the Ninth Circuit on October 24, 1983, is in direct conflict with the decisions of other federal courts of appeals on the same matter. Petitioners list the following decisions as evidence of such conflicts.

In John J. Grier v. U.S., 327 F.2d 668, (7th Cir. 1964), the taxpayer purchased stock in a restaurant in order to take over operation of a supper club and not for investment purposes. The court held that the

ultimate sale of the stock was deductible as an ordinary business loss.

In Steadman v. Commissioner, 424 F.2d 1 (6th Cir. 1970), the court held that the taxpayer purchased stock in a client corporation, not with the expectation of dividends or capital growth, but in order to retain the corporation as a client. It was held that the ensuing loss was deductible from ordinary income.

In Van Clief v. Helvering, 135 F.2d 254, (D.C.Cir.1943) the court said "... the fact that Van Clief made the advances to keep the corporation afloat rather than to liquidate it, have no tendency to show that a voluntary addition to capital rather than a loan was intended." The Court held that the inference of indebtedness from a loan to a corporation is not rebutted by the fact that the loan was made by a sole stockholder to his corporation.

The decision by the United States Court of Appeals for the Ninth Circuit, which held that amounts paid by Petitioners herein to or on behalf of a corporation were capital contributions, rather than loans, is clearly in conflict with the other federal court of appeal decisions listed above. Therefore, it is necessary that a Writ of Certiorari be granted to secure review of the decision rendered against Petitioners in the United States Court of Appeals for the Ninth Circuit.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,
SANKARY & SANKARY

Morris Sankary

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January 23rd, 1984

APPENDIX "A"

JOURNAL ENTRY OF JUDGMENT OF THE TAX COURT

JUDGMENT OF THE U.S. COURT OF APPEALS

T. C. Memo. 1982-387

UNITED STATES TAX COURT

MORRIS SANKARY and WANDA SANKARY, Petitioners v. COMMISSION OR INTERNAL REVENUE, Respondent

Docket No. 2496-80 Filed July 12, 1982.

Morris Sankary, pro se.

Karen Nicholson Sommers, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FAY, Judge: Respondent determined deficiencies in an addition to petitioners' Federal income tax as follows:[1]

Year	Deficiency	Sec.6653(a) Addition To Tax
1970	$ 421.02	-
1971	4,785.35	-
1972	43,806.00	$2,190.30
1973	31,028.00	-
1974	25,030.80	-

[1] Unless otherwise provided, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

After concessions, the issues are (1) whether certain payments were loans or contributions to capital; (2) if the payments were loans, whether they were made in connection with a trade or business; (3) in what year certain stock or debts became worthless; and (4) whether the failure to report a gain in 1972 was due to negligence.[2]

FINDINGS OF FACT

Some of the facts are stipulated and found accordingly.

Petitioners, Morris Sankary and Wanda Sankary, resided in San Diego, Calif., when they filed their petition herein.

Morris Sankary (hereinafter petitioner) is a lawyer in private practice. His law practice consists largely of work connected with low-

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[2] Resolution of the first three issues listed above will resolve any issue as to claimed net operating loss deductions based on carryovers and carrybacks.

cost housing development. In late 1968, petitioner was approached by Thomas Sutherland and Michael Ryan concerning a business then known as Granada Plastics Co. At that time, Sutherland and Ryan were Granada employees. Sutherland and Ryan had two requests of petitioner: (1) to represent them concerning an emerging business deal with Diner's Club, Inc. and [3] (2) to solicit help in exercising an option they had to acquire Granada from its owner.

In 1968 Granada was a sole proprietorship owned by Harold J. Kurt. Its primary business was the manufacture of expanded polystyrene panels, and it had developed a prefabricated housing system which used those panels. Some-

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[3] The deal with Diner's Club, Inc., concerned the erection of a floating hotel complex for which Granada or its successor would supply the floatation system. Petitioner's representation included negotiations with the San Diego Port Authority. Apparently, the deal later fell through.

time in 1968, Kurt suffered a stroke and granted four of his employees, including Sutherland and Ryan, an option to acquire Granada. If unexercised, the option was to expire March 10, 1969. In October 1968, Sutherland, Ryan, and Douglas E. Leston formed Continental Components Corporation, a California corporation, intending the corporation to exercise the option.[4]

When formed, Continental Components Corporation (hereinafter CCC) was authorized to issue 75,000 one dollar par shares of stock. However, no shares were initially issued and, for awhile, CCC was a mere shell. Sutherland and Ryan did not have the money necessary for CCC to exercise the option.

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[4] The option agreement permitted exercise of the option by a partnership or corporation. While not one of the employees named in the option agreement, Douglas E. Leston participated. However, he resided as a director of Continental Components Corporation in February 1969.

Thus, as reflected in CCC's November 1, 1968, minutes, they agreed to "immediately commence action in an attempt to secure an investor or investors with the sum of Seventy-five thousand dollars ($75,000) to be loaned to the corporation* * *." Further, those minutes state:

"It is contemplated that the money so secured will be exchanged for capitol [sic] stock *** if the same is approved by the Commissioner at a later date."[5]

In March 1969, petitioner transferred $1,000 to CCC and received CCC shares. No other CCC shares were ever issued. The parties agree petitioner was CCC's sole shareholder from March 1969 until CCC ceased operation. Sometime in 1969, petitioner advanced

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[5] Apparently, "Commissioner" refers to the California Corporation Commissioner.

$100,000 to CCC.[6] Apparently, sometime in March 1969, CCC exercised the option and took over Granada's business.[7] In November 1969, petitioner guaranteed a $100,000 loan to CCC from Southern California First National Bank. The proceeds of that loan were put in a time certificate of deposit and pledged as collateral for the loan. Petitioner intended such "paper transaction" to evidence an intent that the original $100,000 advanced by him to CCC was a loan. The record does not reveal

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6 Enclosed in a letter dated March 14, 1969, from petitioner to Thomas A. Comstock, an attorney for Granada's then owner, was a $15,000 check drawn on petitioner's personal account with instructions that it not be cashed because "[i]t is my [petitioner] intention to * * * loan the funds evidenced by this check to the corporation and give you a certified check prior to close of escrow.

7 We make our finding as to exercise of the option as "apparent" because there is no direct proof of such. However, the whole trial proceeded with such as an obvious assumption.

whether the time certificate of deposit was in petitioner's name or in CCC's name.

Initially, Sutherland served as CCC's president, and petitioner was CCC's secretary-treasurer and counsel. Sutherland died sometime after petitioner became sole shareholder of CCC. After Sutherland died, petitioner served as CCC's president.[8] While CCC's polystyrene panels drew a great deal of attention and CCC showed great promise of financial success, CCC never thrived in actuality. A series of attractive deals either fell through or failed to live up to

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[8] The record does not reveal when Sutherland died. We have before us documents dated August 12, 1969, and December 15, 1969, which Sutherland signed as president of CCC and petitioner wrote as secretary-treasurer of CCC, respectively. We also have before us a document dated July 13, 1970, which petitioner wrote as president of CCC. Thus, we assume Sutherland died after December 15, 1969, and before July 13, 1970.

expectations.[9] However, at least through mid-1970, it appeared CCC was in a position eventually to do very well.

In 1970, petitioner guaranteed a $300,000 loan from Wells Fargo Bank to CCC. The exact date of the loan is not revealed on the record. The $300,000 was used in part to pay off the $100,000 loan from Southern California First National Bank. The $100,000 time certificate of deposit was pledged as collateral to Wells Fargo along with securities, unrelated to CCC, owned by petitioner.[10]

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[9] For example, 1969 deals to erect a series of prefabricated post offices, and to supply panels for an entire development in Orange County, Calif., both fell through. Contracts with a builder for add-a-rooms and with Westward Coach Corporation for up to 1.5 million dollars worth of panels never produced their expected revenues. Other transactions, such as air cargo container manufacturing and numerous housing development projects, were in the works but produced little.

[10] Petitioner's basis in those pledged securities was $130,561.19.

Despite great promise, CCC failed. In 1971, Wells Fargo Bank applied the $100,000 time certificate of deposit to the loan petitioner guaranteed. In 1972, petitioner paid Wells Fargo Bank $46,400 on the CCC loan and paid third parties $8,654.66 on CCC's behalf. In 1973, petitioner paid Wells Fargo Bank $29,508 on the CCC loan and paid third parties $10,250 on CCC's behalf. Also in 1973, Wells Fargo Bank sold petitioner's pledged securities and applied the proceeds to the CCC loan. In 1974, petitioner paid third parties, $4,400.24 on CCC's behalf.

Petitioner's actions as a representative and officer of CCC and his actions as an individual often were entwined. For example, a December 1970 agreement concerning exclusive rights to a glue for use with polystyrene panels was executed by petitioner individually but noted petitioner was the sole CCC shareholder. The same was true with respect to an

August 1971 contract concerning the development of a solid standing styrene panel. In March 1969, petitioner bought land adjacent to CCC's plant to lease to CCC. At other times, he bought equipment to lease to CCC.[11] Petitioner's work with respect to CCC led to other contacts. For instance, he went to both Germany and Israel to discuss low-cost housing development using panels, and he formed a number of California corporations with businesses related to CCC's business. Although petitioner served as both counsel and an officer of CCC, he was never paid. An amount owed him was accrued on CCC's books and records. The other CCC employees were paid.

Early agreements to sell the CCC stock fell through. In October 1969, petitioner negotiated with Westport Enterprises, Inc.,

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[11] No rent to petitioner was ever paid by CCC. Any such payments merely were accrued on CCC's books.

for the exchange of his CCC stock. A "tentative understanding" provided Westport would pay petitioner $100,000 worth of Westport common stock and $89,000 on the understanding petitioner had "loaned or advanced" that amount to CCC. Additionally, Westport would divide $50,000 worth of its common stock between Sutherland (70 percent), Ryan (15 percent), and Marshall Welty (15 percent, and would guarantee those individuals set salaries.

A letter dated December 19, 1969, from petitioner to a representative of Hubble Development Company discussed a "possible future merger" of CCC and Hubble. That letter noted liabilities of CCC as being a $100,000 bank note, $25,000 in current obligations, $40,000 in equipment payments, and $25,000 in needed operating capital. Petitioner proposed that Hubble agree to assume those liabilities, to give Sutherland guarantees via an employment

contract and stock option, to give petitioner a retainer agreement, and to give petitioner a 49 percent interest in Hubble. All this would be in exchange for petitioner relinquishing a 51 percent interest in CCC.

On February 7, 1972, petitioner signed a Letter of Intent with Odis Walton and Associates (Walton), evidencing plans for petitioner to sell all the CCC stock. That Letter of Intent noted petitioner "has spent over three years developing [CCC] * * * and has spent approximately $500,000 in developing [CCC] to its present status." The $500,000 was noted as being made up of cash investment, personal loans, guaranteed bank loans, services, and "general creditor indebtedness." While no breakdown was given, the guaranteed $300,000 loan from Wells Fargo Bank was noted specifically.

The basic agreement evidenced by the Letter of Intent was that, in exchange for all

the CCC stock, Walton would relieve petitioner's personal guarantee on the Wells Fargo Bank loan, secure return of petitioner's pledged securities and the time certificate of deposit, pay third parties $42,000, and provide necessary working capital while holding petitioner harmless. Pursuant to the agreement, CCC's operations and books and records were turned over to Walton. Walton later defaulted by failing to pay state taxes, and local authorities closed CCC. Petitioner never recovered the surrendered books and records.

In January 1973, petitioner negotiated an agreement with North American Funding, Inc. Basically, that agreement gave North American a nonexclusive license to manufacture the entire line of CCC's products for a certain amount per panel. However, with an eye toward CCC's "loss carry-forward" the agreement provided for an exchange of petitioner's CCC

stock for $30,000 shares of North American's ten cent par value common stock. The North American agreement was never carried out.

The initial capitalization of CCC was limited to the $1,000 paid in by petitioner. The debt-to-equity ratio reflected on CCC's Federal income tax returns was $241,758 to $1,000 and $363,833 to $1,000 on October 31, 1970, and October 31, 1971, respectively. Those returns also report loans from shareholders of $1,250 and $30,617.49, as of October 31, 1971, and October 31, 1972, respectively. The return for CCC's fiscal year ending October 31, 1972, reports $115,839.01 as "contributed surplus."

On their Federal income tax returns for 1972, 1973, and 1974, petitioners claimed as ordinary losses the amounts petitioner forfeited on CCC's behalf. Additionally, petitioners claimed those losses gave rise to net operating loss deductions based on carryovers

and carrybacks in all the years in issue. In his statutory notice of deficiency, respondent determined petitioner sustained capital losses in 1973 and 1974 rather than ordinary losses in those or any other years.

OPINION

The principal issue before us is whether certain payments made by petitioner to or on the behalf of CCC were loans or contributions to capital.

If the payments were contributions to capital, they can only give rise to capital loss when the CCC stock became worthless. See sec. 165(g). If the payments were loans, when worthless they can give rise to either ordinary loss if business related or short-term capital loss if not business related. See sec. 166. In 1969, petitioner advanced $1,000 to CCC and received 100 percent of CCC's stock. Also in 1969, petitioner

advanced $100,000 to CCC, apparently so CCC could acquire Granada Plastics. See note 7, supra. In 1970, petitioner guaranteed a $300,000 loan to CCC. In 1971, 1972, and 1973, petitioner paid, in total, $306,469.19 pursuant to that guarantee.[12] In 1972, 1973, and 1974, petitioner paid third parties, in total, $23,304.90 on CCC's behalf. The amount of the ultimate loss petitioner incurred with

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[12] Included within the $306,469.19 is the $100,000 certificate of deposit and petitioner's $130,561.19 basis in securities sold to satisfy the loan obligation. See p.5, supra.

respect to CCC is not in issue.[13]

Respondent maintains all the payments in issue wee contributions to CCC's capital which only give rise to a capital loss deduction in the year the CCC stock became worthless. See sec. 165(g) and 166(e). Respondent contends

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13 We do not treat the 1969 advance of $100,000 made by petitioner to CCC as being either an unpaid loan to CCC or part of petitioner's capital investment in CCC. As we view the facts, if that advance was a loan, it was repaid when the $100,000 time certificate of deposit arose. Petitioner bears the burden of proof, Rule 142(a), and did not address by any evidence the name in which that certificate was issued. When the Wells Fargo Bank loan was obtained, $100,000 of its proceeds were used to pay the Southern California First National Bank loan thus freeing the certificate. Then, the certificate was pledged, along with petitioner's securities, as collateral for the Wells Fargo Bank loan. Such indicates the certificate was petitioner's. Furthermore, the Letter of Intent with Odis Walton and Associates provided for return of both the securities and the certificate to petitioner. Thus, only the amounts paid by petitioner pursuant to his guarantee or the Wells Fargo Bank loan, including application of the certificate and securities to that loan, and amounts paid third parties on CCC's behalf are in issue. See n. 15, infra.

1973 was the year of worthlessness. Petitioner maintains all the payments in issue were in effect loans to CCC which give rise to section 166 bad debt deductions. Alternatively, petitioner contends that, if contributions to capital were made, 1972 was the year the CCC stock became worthless.[14] We agree with respondent that all the payments at issue herein were contributions to CCC's capital; however, we agree with petitioner that 1972 was the year of worthlessness.

Whether a payment by a shareholder to or on the behalf of the corporation is a loan or a contribution to capital is a question of fact. A. R. Lantz Co. v. United States, 424 F.2d 1330 (9th Cir. 1970); Yale Avenue Corp.

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14 Due to our holding, infra, that all the payments at issue herein were contributions to capital, we need not address the parties' arguments concerning whether any bad debts were business versus nonbusiness. See sec. 166(d).

v. Commissioner, 58 T.C. 1062 (1972).[15] In this case, it is a question upon which petitioner bears the burden of proof. See Rule 142(a). We are unable to find that burden has been met.

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15 As previously noted the parties agree petitioner was CCC's sole shareholder from March 1969 until CCC ceased operation. We accept that argument. At various stages in this case, it seemed petitioner was arguing he was never really CCC's sole shareholder, because he only held the CCC shares as security for amounts advanced by him to CCC. However, we have before us no documentation, other than a proposal type reference in CCC's early minutes, indicating petitioner was anything other than both legal and equitable owner of CCC's shares. In various business dealings, petitioner represented himself as CCC's sole shareholder. Twice in 1969, petitioner negotiated for the disposition of the CCC stock. In one he would have received $100,000 worth of the acquirer's shares and payment of amounts advanced to CCC. In the other, CCC's liabilities would have been assumed, and petitioner would have retained a 49 percent interest in CCC and obtained a 49 percent interest in the acquirer. Both negotiations treat petitioner as owning the CCC stock. Given petitioner's status as sole shareholder, it cannot be questioned the $1,000 originally paid for the CCC shares was a contribution to capital.

As the United States Supreme Court noted in John Kelley Co. v. Commissioner, 326 U.S. 521, 530 (1946), there is no single factor from which a determination of debt versus equity may be made. Instead, all the circumstances must be considered before an answer may be reached. Nevertheless, petitioner contends he intended loans, and, therefore, loans they were. While the intent of the parties is of paramount importance in separating loans from contributions to capital, neither the taxpayer's statement of intent nor any documentary characterization is binding. See A. R. Lantz Co. v. United States, supra; Thompson v. Commissioner, 73 T.C. 878 (1980).

Petitioner offers only two pieces of documentary evidence to buttress his testimony that the payments were loans. One is a letter to the attorney for Granada's former owner wherein petitioner expresses an intent to loan

funds to CCC. The other is the December 1969 negotiations with Hubble Development Company. Neither is convincing. The letter to the attorney concerns only a $15,000 advance proposed in 1969. It bears little perceivable relation to the amounts at issue herein. While the early 1969 occurrences are generally relevant, our primary concern is directed at events as they existed in 1970 when the Wells Fargo Bank loan was made.[16] Such is true because, when a payment is made in satisfaction of a guarantee, the debt versus equity analysis is made with a view to when the guarantee is made rather than to when payment is made. See Putnam v. Commissioner,

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16 The record does not reveal the source of petitioner's obligation to the third parties to whom he made payments on CCC's behalf. See discussion of those payments at n. 21, infra.

352 U.S. 82 (1956); Arrigoni v. Commissioner, 73 T.C. 792 (1980).[17]

Even is we were convinced petitioner made any 1969 loans to CCC, see note 13, supra, such would hardly be dispositive with respect to the 1970 guarantee.

In regard to the December 1969 negotiations with Hubble Development Company, we fail to see how those negotiations support petitioner's position. In fact, the only documentary evidence, authored by petitioner, of those negotiations notes CCC's liabilities as including a $100,000 bank loan, but does not refer to any loans by petitioner. Stated summarily, petitioner has given us little but his statement to support his loan

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17 Petitioner also relies on four checks, totaling $1,400, issued by him to Sutherland and Ryan in March 1969. Two of those checks carry handwritten, margin notations of "loan". We do not find the checks supportive of petitioner's position.

characterization.[18]

We have before us no notes or other indicia of indebtedness. Petitioner maintains he received demand notes from CCC carrying 7 percent interest.[19] Yet, such notes were not introduced. While CCC's books and records were lost to petitioner when they were turned over to Odis Walton and Associates in 1972,

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18 Petitioner's basic premise seems to be that he "loaned" CCC funds to keep CCC going in anticipation of CCC becoming a valuable client in this law practice. Petitioner offered a plethora of papers to demonstrate the scope and nature of this law practice. However, most of those papers reveal petitioner was often an investor looking to profits in addition to or instead of a lawyer earning fees. In only one document relevant herein is petitioner's position as an attorney noted prominently. In his proposal to Hubble Development Company, he suggested he be given a retainer agreement. However, the same proposal suggested a continuing equity interest which seems to be dominant.

19 It is unclear as to which payments, i.e., the original $100,000 advance or the Wells Fargo Bank loan guarantee payments, petitioner maintains those notes related.

that does not explain the absence of any notes given to petitioner from CCC. While we draw no inferences from petitioner's failure to introduce CCC's books and records, given their unavailability, we do pause at petitioner's failure to introduce notes presumably in his possession or to offer any supporting testimony other than his own. Furthermore, CCC's Federal income tax return reports $115,839.01 as "contributed surplus" and $30,617.49 as loans from shareholders. Petitioner offered no explanation of those figures, and, as previously noted, it is he who carries the burden.

In addition to petitioner's lack of proof, several factors indicate the payments were contributions to capital. The initial stated capital of CCC was only $1,000 while the purported loans at issue herein total over $300,000. An inadequate or "thin" capitalization indicates advances may well be

further capitalization rather than loans. Jewell Ridge Coal Corporation v. Commissioner, 318 F.2d 695, 699 (4th Cir. 1963), affd. a Memorandum Opinion of this Court. Additionally, CCC's business was speculative in that it was operating in a relatively new field. While a number of attractive deals arose, none ever lived up to expectations. While through mid-1970 it appeared CCC eventually might do very well, we are unconvinced independent lenders, absent petitioner's guarantee,[20] would have advanced CCC funds. Such can indicate a capital contribution. See generally Schnitzer v. Commissioner, 13 T.C. 43 (1949), affd. 183 F. 2d 70 (9th Cir. 1950).

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[20] Furthermore, while we have been able to find CCC was in a position eventually to do well at least through mid-1970, we do not know when in 1970 the Wells Fargo Bank loan was made. It could have been made in early 1970 when things wee looking up or in late 1970 when things were beginning to slide. Again, petitioner has failed to provide us with relevant information.

In summary, petitioner has offered little, if any, evidence to support his assertion that loans were intended. When coupled with other factors indicating capital contributions were more likely than loans, we only can conclude petitioner has failed to meet his burden of proof. Thus, we find all the payments at issue herein were contributions to capital.[21]

Having found the payments were contributions to capital, they are deductible as part of petitioner's basis in CCC only in the year the CCC stock became worthless. See

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21 Our discussion, supra, concentrates mainly on the payments made with regard to the Wells Fargo Bank loan guarantee, because all we know about the payments made to third parties is that they were made to third parties on CCC's behalf, their amount, and the year in which they were paid. Their origin is left as a mystery to us. Thus, with respect to the third party payments, petitioner's failure of proof is even more glaring.

secs. 166(e) and 165(g).[22] The parties disagree as to whether 1972 or 1973 is the year of worthlessness.[23]

The year in which stock becomes worthless is a question of fact. See Scifo v. Commissioner, 68 T.C. 714 (1977). As a general rule, worthlessness may be established by showing "some 'identifiable event' in the corporation's life which puts an end to * * * hope and expectation." Morton v. Commissioner, 38 B.T.A. 1270, 1279 (1938), affd. 112 F.2d 320 (7th Cir. 1940). Petitioner, pointing to the faltered sale to Odis Walton and

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22 Section 165(g) mandates capital loss in this situation. Petitioner does not contend it is other than long-term capital loss in this case.

23 Of course, the $4,400.24 paid to third parties in 1974 is not deductible until 1974. Likewise, if 1972 is the year of worthlessness, payments made in 1973 are not deductible until 1973, since petitioner was a cash basis taxpayer.

Associates followed by the closing of CCC's business, maintains the CCC stock became worthless in 1972. Respondent, pointing to the negotiations with North American Funding, Inc. in January 1973, contends 1973 was the year of worthlessness. We agree with petitioner.

By 1972, CCC had suffered a series of los business opportunities. When the Letter of Intent was signed with Odis Walton and Associates in February 1972, CCC had little value. The content of that letter boils down to a recoupment of losses and no more. When the deal fell through, CCC went under. The mere fact that petitioner attempted unsuccessfully to derive something from his CCC investment in 1973 shows him to be more of an "incorrigible optimist" than anything else. See generally United States v. White Dental

Co., 274 U.S. 398 (1927).[24] In fact, a fair reading of the North American agreement might be that North American was interested in CCC's losses more than anything else. Thus, we find 1972 was the year in which the CCC stock became worthless.

Negligence Addition To Tax

FINDINGS OF FACT

On their Federal income tax return for 1972, petitioners failed to report a capital gain of $20,843.17 from the sale of real property. When the return was prepared, petitioner was in Israel. Petitioner's wife, Wanda Sankary, also an attorney and a petitioner herein by virtue of the filing of joint returns, gave petitioners' records to an accountant for preparation of the 1972 return. Due to an oversight, the capital gain was not included on the return. In his statutory notice of deficiency, respondent asserted failure to report the capital gain was due to

negligence and determined a section 66553(a) addition to tax for 1972.

OPINION

There is no dispute petitioners failed to report a sizeable capital gain on their 1972 Federal income tax return. However, they contend it was mere "oversight" instead of negligence.

Section 6653(a) imposes an addition to tax if any part of an underpayment is due to negligence. Once respondent determines liability for such an addition in his statutory notice of deficiency, the burden rests with petitioners to show such determination was erroneous. Enoch v. Commissioner, 57 T.C. 781, 802 (1972). The mere fact that information was turned over to an accountant and an "oversight" was made does not absolve petitioners. See Pritchett v. Commissioner, 63 T.C. 149, 174 (1974). We sustain respondent's determination that

petitioners are liable for the section 6653(a) addition to tax for 1972.

To reflect concessions and the foregoing,

Decision will be entered under Rule 155.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MORRIS and WANDA SANKARY, Petitioners-Appellants, vs COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee,	TAX# 2496-80 No. 83-7078 JUDGMENT Southern California

Upon Petition to Review a Decision of The Tax Court of the United States,

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, on October 7, 1983 and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court of the United States in this Cause be, and hereby is AFFIRMED.

Filed and entered October 24, 1983

APPENDIX "B"

ORDER ON REHEARING

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MORRIS AND WANDA SANKARY,	)	
	)	
Petitioners-Appellants,	)	NO.83-7078
	)	
vs.	)	TAX COURT NO.
	)	2496-80
COMMISSIONER OF INTERNAL REVENUE,	)	ORDER
	)	
Respondent-Appellee.	)	
	)	

Before: FARRIS and REINHARDT, Circuit Judges, and and SOLOMON, District Judge*

The petition for rehearing is denied.

APPENDIX "C"

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code Section 166(a)(1) provides as follows:

(1) WHOLLY WORTHLESS DEBTS - There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

Internal Revenue Code Section 166(d)(1) provides as follows:

In the case of a taxpayer other than a corporation:

(A) Subsections (a) and (c) shall not apply to any business debt; and

(B) Where any non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than one (1) year.

(2) For purposes of Paragraph (1) above, the term "non-business debt" means a debt other than:

(A) a debt created or acquired (as the case may be) in connection with a trade of business of the taxpayer; or

(B) a debt the loss from the worthlessness which is incurred in the taxpayer's trade or business.

Treasury Regulation Section 1.166-1(c) states that:

A bonafide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money.

DECLARATION OF SERVICE BY MAIL
(C.C.P. 1013a and 2015.5)

I, the undersigned, say: I am over 18 years of age employed in the County of San Diego, California, in which county the within mentioned mailing occurred, and not a party to the subject cause. My business address is 110 West "C" Street, Suite 714, San Diego, California 92101.

I served the Petition for Writ of Certiorari,

of which a true and correct copy of the document filed in the cause is affixed, by placing a copy thereof in a separate envelope for each addressee named hereafter, addressed to each such addressee respectively as follows:

1. Internal Revenue Service (3)
   Attn: Donald W. Wolf, Esq.
   District Counsel
   940 Front St, Room 2-N-16
   San Diego, CA 92189

2. U.S. Supreme Court (40)
   Office of the Clerk
   Washington, D.C. 20543

Each envelope was then sealed and with the postage thereon fully prepaid deposited in the United States mail by me at San Diego, California, on February 13, 1984.

I declare under the penalty of perjury that the foregoing is true and correct.

Executed on February 13, 1984, at San Diego, California.

S.I. Smith
S.I.Smith

END OF DOCUMENT